

Chapter 3

Breaking the Herd

Leveraging Financial

Mindfulness to Combat

Investor Herding Behavior

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ABSTRACT

This chapter examines herding behaviour in investors that affect the financial market. Herding involves investors mimicking others' actions due to factors like limited information, market sentiments, and psychological biases. Individual investors, less informed and more susceptible to emotions, herd more. Drawing from Buddhist economics, financial mindfulness emerges as a crucial intervention to mitigate herding. It promotes awareness of one's financial situation, enhancing independent decision-making and reducing impulsive behaviour. Empirical evidence supports mindfulness-based interventions in improving financial decisions and managing debt effectively. By cultivating a thoughtful approach to finance, financial mindfulness empowers investors to resist herd behaviour, fostering stability in financial markets.

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INTRODUCTION TO KEY TERMS

Financial Mindfulness: Mindfulness, originating from Buddhist philosophy, emphasizes being attentive and aware of the present moment. Research indicates that applying mindfulness in finance aids in achieving clarity of perspective and impartiality in financial decision-making (Faugere, 2016). Dr. Dan Stone introduced the term “financial mindfulness” in his book chapter in 2011, defining it as “openness and attention to, and awareness of, present financial events and experiences (Panditharathne & Chen, 2021; Stone, 2012). Essentially, financial mindfulness refers to the heightened awareness and attention one gives to one's financial matters. The practice of financial mindfulness cultivates a healthy attitude towards money, encouraging both financial planning and management. This quality empowers individuals to approach their finances with a balanced mindset, reducing anxiety and promoting better financial health. By maintaining this rational approach, individuals can act ethically and avoid fraudulent practices. (Pereira & Coelho, 2019). Financial mindfulness enhances financial stability and overall well-being by promoting financial planning and management (Faugere, 2016; Panditharathne & Chen, 2021; Pereira & Coelho, 2019; Stone, 2012). In sum, financial mindfulness is a valuable practice that can transform how individuals interact with their finances, leading to more ethical, rational, and effective financial decision-making (Iram et al., 2022b, 2022a).

Herding Behavior: Herding is defined as how investors imitate the actions of other investors (Merli & Roger, 2013). Intuitively, an individual can be considered to be herding if she would have invested without knowledge of other investors' decisions but decides to withdraw it upon discovering that others have chosen not to invest (Bikhchandani & Sharma, 2000). In the herd effect, while an individual's behaviour may be rational, it can result in collective irrational behaviour. (Liu et al., 2019). Investors herd mainly due to the unavailability of accurate information, reputational concerns and sometimes for speculative motives. Different behavioural theories have been applied to study herding behaviour. Herding occurs among both institutional and individual investors (Li et al., 2017). Herding has to be differentiated from spurious herding where a group of investors react similarly to a publicly available information (Bikhchandani & Sharma, 2000). In the case of spurious herding, there is no blind imitation of other investors.

Behavioural Bias: In simple terms, bias is a prejudice that affects financial decisions, influenced by underlying beliefs (Chira et al., 2008). According to Hersh Shefrin, behavioural bias means “predisposition towards error” (Shefrin, 2001). The behaviour of investors in the financial market is driven by behavioural bias (Agrawal, 2012). There are many types of bias that affect the individual's decision-making process. Each bias exists in a person due to different reasons. Gender, cultural traits, educational background, personality types etc., will contribute towards the

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